

Monthly Research Bulletin

ISSUE 2 | JULY 2010

In this issue

Simplification is
the key

State pension age
increase to 66

The end of
compulsory
annuities

Health issues and
enhanced annuities

The pensioners'
incomes series
2008-09

Escalating pensions

A decent pension

Tax relief

May and June
inflation



Research Bulletin

This issue of the Research Bulletin focuses on pensions. With a new Government in place and keen to make progress, most aspects of the pensions system are under review. We have consultations on state pension age, compulsory annuitisation, index-linking of pensions in payment, restricting tax relief and public sector pensions. Many of the proposals are due to find their way into the next Finance Bill with next year's Budget, so it is worth starting by looking at the CPS paper produced by Michael Johnson; "Simplification is the key," which seems to have informed most of the changes under consideration.

In addition to some of the consultations, this issue also looks at the income of pensioners, tax relief on pensions, health in retirement and the cost of a decent pension.

This is an exciting time and there are many issues to consider, especially the impact of legislative changes on individuals. Freedom and flexibility in pension planning is a good thing provided those exercising the flexibility understand the impact of the freedom they have. Lack of engagement in pensions, understanding of life expectancy and the impact of investment volatility in the decumulation phase can significantly damage individuals' hopes for a comfortable retirement and it is important that these issues are addressed. The issues of advice and information will play a crucial role in ensuring best use is made of the new rules by all concerned.



Simplification is the key – from centre for policy studies

“Simplification is the key,” a CPS paper, by Michael Johnson, presents and interprets a vast amount of data surrounding private pensions and savings from a number of sources. The paper maintains there are many factors that inhibit retirement savings, not least the complexity of the tax treatment of savings products, and proposes drastic simplification of pension rules and tax relief. He makes 16 proposals to simplify saving and improve flexibility by bringing pensions and ISAs closer together. These include:-

- A limit of £45,000 a year for tax-incentivised savings, with pension savings limited to £35,000 and tax relief at the individual’s marginal rate
- Early access to up to 25% of the pension fund
- Abolish the requirement to annuitise provided that a minimum of £50,000 at SPA is not accessed until the age of 75
- Allow couples to contribute to each other’s pensions
- Allow pension funds up to a certain limit to be passed to third parties’ pensions on death with no IHT

Subsequent to this, the Budget on 22nd June confirmed that the Government will be looking to implement a reduced Annual Allowance of between £30,000 and £45,000 and the effective requirement to purchase an annuity at age 75 has been abolished.

Mr Johnson uses data from Wealth in Great Britain to demonstrate that the poorest 40% of households own 2% of the pension wealth, while the wealthiest 5% own 43% of pension wealth. While fewer people are saving in pensions as a result of the credit crunch, the better off are saving more.

The paper highlights the gender gap in pensions. 90% of men retire with a full Basic State Pension but only 25% of women do. While defined benefit schemes are shown to provide generally good results for men, the disrupted working patterns and generally lower earnings for women result in significantly worse outcomes within DB schemes. The gap is projected to rise

He does not believe that raising the State Pension Age is likely to fix the problem caused by an ageing population as many people will be unable to find work and will become dependent on other State benefits. He also points out that, in Japan, higher state pensions and the introduction of public long-term care insurance have been among the factors that have led to a significant decline in the savings rate as the population has aged.

UK pension saving in 2008 totalled around £82 billion, £32.7 billion of which were employer contributions to funded schemes. Employer contributions to personal pensions accounted for £9.7 billion. Total UK pension assets at the end of 2007 were £1,955 billion while the total market value of ISAs was £207.8 billion. UK pensioners are more reliant on private pension provision than any other country in the OECD which does not have compulsory private provision. The proportion of Britons on course to enjoy an adequate retirement income is reported to be 50%.

In 2007-2008, employee savings into ISAs (£35.7 billion) exceeded total employee pension contributions (£27.9 billion) and attracted much less tax relief.

The report maintains that ISA savings are persistent, partly due to inertia and, over time, many come to consider them as an integral part of retirement savings. Mr Johnson maintains that his proposals, coupled with restriction of tax relief on pension contributions to basic rate, would save £6 billion to £7 billion per year on top of the measure taken by the previous Government which has now been scrapped and calls for further research to determine the effectiveness of up front tax relief and how it influences savers’ behaviour. There is a claim that many people, particularly the low-paid, do not even appreciate that tax relief is available on pension contributions.

Combining ISA and pensions is claimed to meet people’s desire for flexibility, instant access to funds and retaining tax advantage of pensions. It is pointed out that this flexibility is already available from lifetime savings platforms which enable savers to maintain and monitor the value of their funds in the one place and manage them in a coherent fashion.

We have already seen movement towards two of the proposals in this latest report and the Government is looking into the possibility of early access to pension funds.





State pension age increase to 66

State Pension Age Increase to 66

The previous Government had put in place plans to increase the State Pension Age to 66 by 2026, to 67 by 2036 and to 68 by 2046.

State Pension Age for women started to rise with effect from 6th April 2010 with a view to equalising the age at which both men and women could draw the State Pension at 65 by 2020. Thereafter the SPA for both men and women would rise as described above.

Before the general election, the Conservatives had indicated an intention to accelerate the rise in SPA due to the fact that life expectancy is continuing to rise. The call for evidence, issued in June, represents the current Government moving to fulfil one of its commitments.

Background

The call for evidence contains the following comments:-

- When the first contributory pension was introduced in 1926, the men receiving it lived, on average, until the age of 76. Women lived on average to age 78
- Today, men are expected to live until 86 and women to 89
- Since the current SPA increases were set in 2007, projected male average life expectancy (at SP) has increased from 85.0 to 86.3. Projected female life expectancy has increased from 87.2 to 88.7
- Increases in life expectancy are expected to continue
- For people retiring in 2010, the increase in life expectancy is expected to add £6.5 billion to State spending over their lifetime
- The support ratio (number of adults under 65 to number over 65) is projected to drop from 4:1 to 3:1 within 10 years and 2:1 within 30 years

Proposal

It has been widely reported that the SPA will rise to 66 in 2016 but the call for evidence and press release accompanying it do not mention any specific date. 2016 is the earliest date from which the SPA will rise but it may be later.

Ultimately the SPA may rise to age 70, possibly higher, and probably before 2046.

There is no mention of changes in the age at which State Pension Credit becomes available or changes to any other means-tested benefits but it is likely there will be some effect.

The Government will also be reviewing the so-called default retirement age, at which employers can require employees to retire, and will investigate other methods of encouraging and enabling people to work longer. This is an essential move if the SPA is to increase and reflects a growing interest in late retirement among significant numbers of people.

What is the call for evidence?

The document asks for responses to 3 questions from interested parties, either individuals or organisations who have information that is relevant to the timing of an increase in SPA. These are:-

1. What evidence concerning changes in life expectancy and the changed economic context should be taken into account when bringing forward the increase in SPA to 66?
2. What evidence should the Government consider in deciding the notice period for individuals affected by a change to the timing of the SPA increase?
3. What evidence should the Government consider to ensure no group is disproportionately impacted by the level of the SPA and any change to the timing of the SPA increase?

Evidence is required by 6th August 2010 and the Government will publish its response in the autumn.

The end of compulsory annuities

For some time the Conservatives have pledged to abolish the requirement to purchase an annuity by age 75 and a new consultation now promises to deliver on this pledge.

Well it's finally arrived. On 15th July, HM Treasury launched the consultation into removing the requirement to purchase an annuity with pension funds by age 75. What does it mean for annuities?

New choices

At retirement, and afterwards, individuals will have a choice of:-

- a lifetime annuity
- capped drawdown
- flexible drawdown

Although the title focuses on age 75, these choices will be available from retirement at any age (allowing for the minimum pension age). There will be a Lifetime Allowance Test at age 75 if benefits have not been drawn.

Capped drawdown will be very similar to current Unsecured Pension but with a more restrictive upper income limit, the details of which are yet to be determined.

Flexible drawdown will allow uncapped drawdowns once the individual can demonstrate to the satisfaction of the provider that they have sufficient guaranteed income to prevent them from exhausting their savings and falling back on the state at any time. Thus anyone in drawdown will be in capped drawdown unless they can meet this Minimum Income Requirement at the point they wish to exceed the capped limit of income withdrawal. Any income drawn will be taxed at income tax rates.

An interesting point about flexible drawdown is that the individual will need to satisfy the provider that they have sufficient resources to meet the Minimum Income Requirement before they can take additional drawdowns.

These choices will be available throughout retirement: Alternatively Secured Pension (ASP) will be abolished as soon as the new legislation comes into force. Anyone in ASP will automatically fall into capped drawdown when the new legislation takes effect.

Minimum Income Requirement (MIR)

The level of the MIR has yet to be set but may be an amount well in excess of the Guarantee Credit and will include some element of escalation. The level for each individual will be dependent on their age. The consultation paper includes details of the Minimum Income Standard, recently published by the Joseph Rowntree Foundation and Expenditure Needs, from ONS:

- Minimum Income Standard
 - £147.41 per week for a single person (before housing costs)
 - £222.22 for a couple (after housing costs).

- Expenditure Needs
 - £151.30 - £185 per week for a single person (before housing costs)
 - £337.70 per week for a couple (after housing costs)

The ONS estimates are very close to the median pensioner income according to the Pensioners' Income Series.

The MIR may even include some allowance for future costs of care.

Under the current proposals, only pension provision would count towards the MIR. This would include:

- State pensions (Basic State Pension and any second tier state pension)
- Lifetime annuities with Limited Price Indexation (LPI) - capped at 2.5%
- Scheme pensions from occupational schemes that include at least LPI escalation

Death benefits

Much attention has been paid to the tax treatment of transfers on death under ASP and the consultation paper addresses this issue by introducing a flat tax rate of 55% on funds released. This is a considerable improvement for those currently in ASP but there is a trade-off: the tax rate applies on death any time after pension benefits are crystallised. This means before or after age 75. On death before crystallisation before age 75, funds may still be released free of tax.

Who will qualify for flexible drawdown?

The qualification for flexible drawdown will very much depend on individual circumstances and the final level set for the MIR. A married





couple receiving the full Basic State Pension and, say, £5,000 in Second Tier State Pension would still need to provide a pension of about £7,000 per year to match the ONS expenditure need (which is a net figure) as a guaranteed income, assuming this is the level set for MIR. Allowing for escalation, this pension would cost around £155,000 to provide from an annuity.

Obviously the existence of a defined benefit (DB) pension with appropriate escalation will reduce this amount, as will a lower level of MIR – although this may well defeat the object of this exercise.

Recognising the value of annuities

Despite removing the effective compulsion to purchase an annuity at any age, Mark Hoban MP points out in the introduction that for many people, purchasing an annuity will remain the best way to secure a guaranteed income for life.

While many do not like the principle of handing over their money to an insurer on the grounds that their money is lost if they die early, it should be remembered that life expectancy is increasing and that a significant proportion of people should expect to live well beyond average life expectancy and would struggle to cope if their funds were exhausted beyond that age.

The consultation should result in the end of certain restrictions on Value Protection, enabling clients to enjoy the money back guarantee for longer and in a manner that is easier to understand.

Abolishing ASP will be a welcome move for some and will offer product providers opportunities to develop innovative, albeit complex, products.

Advice considerations

Advice considerations will still remain similar to those that exist today as far as security of income, protection from volatility and avoiding

exhausting pension funds are concerned. The majority of maturing individual pension funds are small and not suitable for exposure to significant risk, such as would be encountered in drawdown. Even fewer will be able to avail themselves of the flexible drawdown option. Other issues to be aware of include:-

- Increase in the tax recovery charge on death prior to age 75 will affect clients in USP as well as those with Value Protected annuities and they will need to be aware of what may happen although there is a possibility of a transitional period in which old rules will continue to apply
- Those currently in USP may see their income limits change for the worse when the legislation is published
- Anyone considering delaying annuity purchase beyond age 75 should be aware of the significant increase in mortality gain in an annuity with increasing age. This will make it progressively more difficult to maintain a growth rate sufficient to match the income available from an annuity, at a time when capacity for risk may well be declining
- A feature that comes out of our review of prevalence of medical conditions is the acceleration of the rate of prevalence of dementia after age 75. Advisers with clients in drawdown will need to ensure that appropriate legal measures are in place to cope in case the onset of dementia is rapid
- HM Treasury has stated that widespread evidence of use of pension funds specifically to avoid IHT may result in a review of the position of funds on death

It is encouraging to see a consultation that tries to facilitate flexibility while improving simplicity. In principle this could increase interest in pensions and thus the security of many more individuals in later life.



Health issues and enhanced annuities

An update on the potential proportion of cases with a condition that might qualify for an enhanced annuity.

Just Retirement launched its enhanced annuity almost 6 years ago, in August 2004. Since then we have developed the annuity through simplification at A-Day and now face more change in the form of the Government's review of annuitisation launched on 15th July this year.

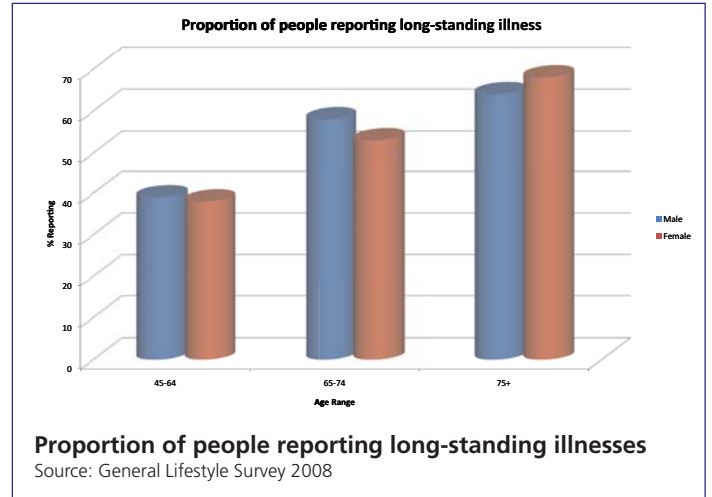
Throughout this period we have continually developed the underwriting expertise and systems to make enhancements available to an increasing proportion of retirees. More than 1,500 conditions of varying severity could qualify, either separately or in combination. Underwriting improvements have made enhancements available across a broader range, from mild to severe conditions.

One of the issues this has thrown up is the need to review the numbers of retirees that have the conditions that may qualify. Over the 13 or so years since enhanced annuities arrived in the UK, there has been a significant change in the types of conditions and the lifestyle factors of people retiring?

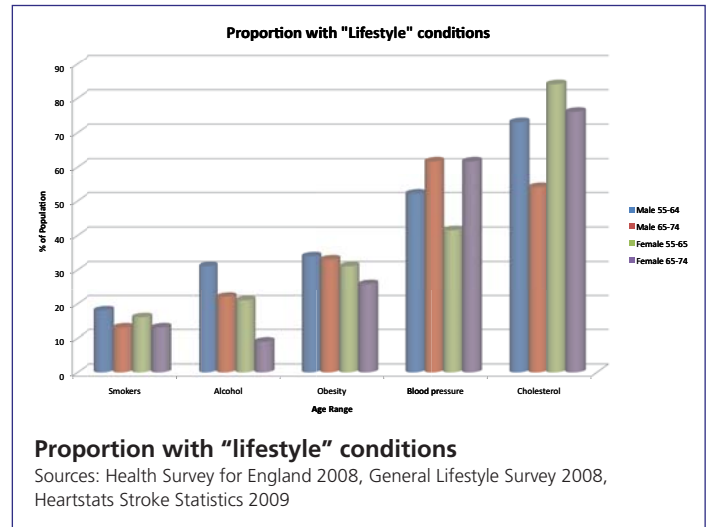
Prevalence of lifestyle and medical factors

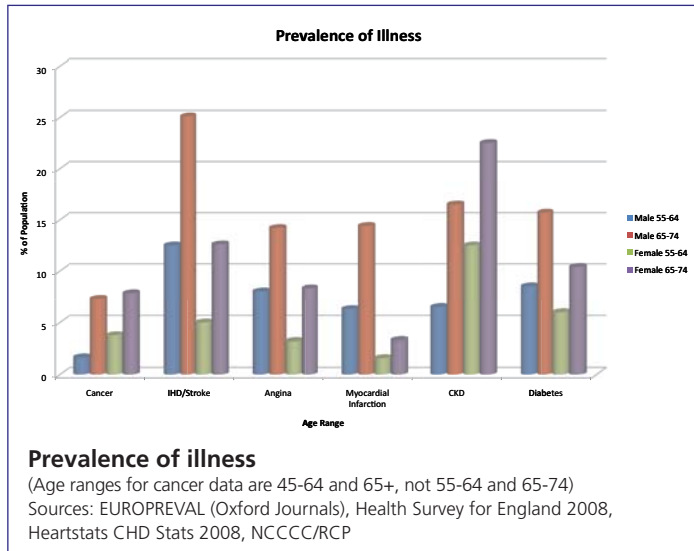
Data covering prevalence of all medical and lifestyle factors is not always easy to find but it is possible to assess the most prevalent conditions from data available from ONS, the NHS, DWP and specialist research organisations. When looking at this data, it is important to remember that it was not gathered specifically for the purpose for which we are using it. Thresholds and limits may be different and samples may not be consistent across all conditions and ages. Lifestyle conditions often rely on self-reported information which can be under- or over-stated (with alcohol and cigarettes, of course, it is usually under-stated) and information on obesity, for example, may depend on other factors, such as waist measurement to assess predisposal to other conditions.

A good place to start to get a general idea of the proportion of people with illnesses is the ONS self-reported long-standing illness data shown in the chart to the right.



For the age range in which people will be buying an annuity, a significant proportion report long-standing illness but, for a more detailed impression we looked at available data for the prevalence of various lifestyle and medical conditions.





A further example is that the prevalence of obesity also has a dramatic impact on various conditions and is implicated to a significant extent in coronary heart disease, ischaemic heart disease, hypertensive disease and kidney disease.

While the effect of combinations is to reduce the overall proportion that may qualify, it should be remembered that the presence of more than one condition can significantly increase the enhancement available in any individual case.

Proportion with conditions that may qualify

This discussion has only covered a small part of the range of conditions that count towards an enhancement and the numbers with multiple conditions. From all the information available it appears that between 55% and 65% of cases could involve clients with conditions that may qualify for an enhancement, especially given that in joint life cases either the annuitant or the dependant could qualify.

This leads to two conclusions:-

1. Enhancements are available to a far greater number of people than are currently claiming them
2. Obtaining as much medical information as possible for each client (and any dependant) offers a good chance of increasing their annuity even further.

Combined conditions

Many individuals will have more than one condition and it is important to account for the impact of lifestyle factors and medical conditions on other aspects of health in order to ensure there is no element of double-counting which would unduly inflate any estimate of the proportion with conditions that may qualify. While comprehensive data is difficult to obtain in this respect, there is some information which highlights particularly the effect of some lifestyle factors.

As an example, Statistics on Smoking in England 2009 from the Health and Social Care Information Centre, NHS, reports that 5% of all hospital admissions for all diseases for adults over 35 in England in 2007/08 are estimated to be attributable to smoking. Of admissions for diseases that can be caused by smoking, 31% were estimated to be caused by smoking, including 50% of the cancers that can be caused by smoking. Our own data also demonstrates that over 30% of those with other lifestyle factors only and 39% of those qualifying with high alcohol consumption also smoke.



The pensioners' incomes series 2008-09

Pensioner Incomes increasing

Pensioners' incomes have grown over the last 25 years as result of increases in income from state benefits, occupational pensions, investments and earnings according to the latest edition of the Pensioners' Incomes Series. The Pensioners' Incomes Series for 2008/2009 produced by the Department for Work and Pensions using the Family Resources Survey (FRS) and the Family Expenditure Survey (FES) examines levels and trends in pensioners' incomes.

The report found that whilst income has increased for all pensioner groups, the rate of increase in income differed between couples and single pensioners, men and women and regionally. Over the last decade, pensioners' average income has grown faster than earnings.

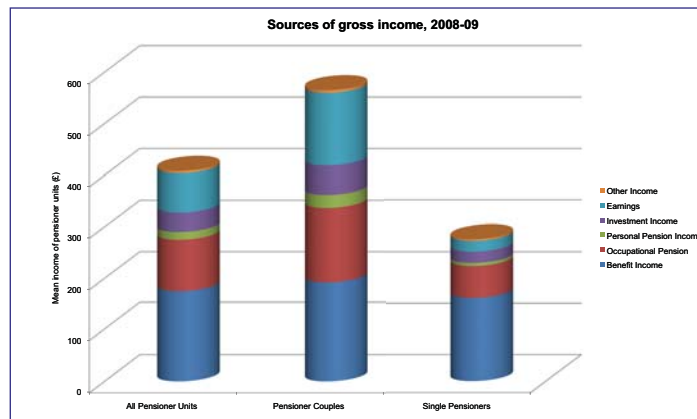
- Overall, net income after housing cost for pensions rose by 38% between 1998-99 and 2008-09.
- Average earnings rose by 12% over the same time.

Constituents of Income

The report showed the breakdown of pensioners' income was:

- 43% state benefits including state pension and disability benefits
- 25% occupational pensions
- 4% personal pensions.

This pattern holds for couples and single pensioners across all ages.

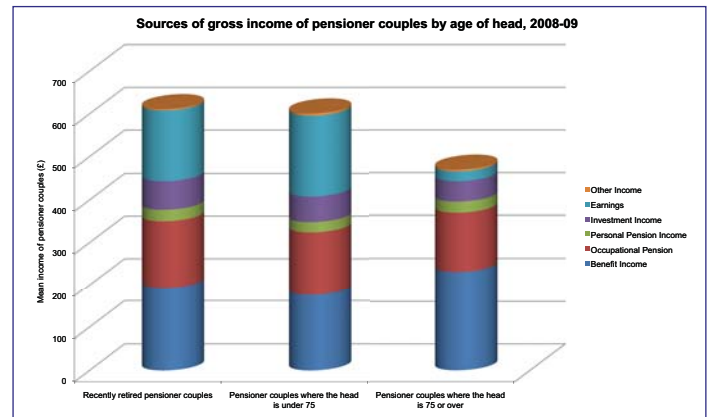


Although average incomes have increased for all pensioner units, there are differences in the level of income within different groups. For example, pensioner couples' occupational pensions and investment incomes are two and a half times the level of single pensioners' incomes. Bear in mind pensioner couples can include couples where one partner is under state pension age and may still be working.

Age and Gender Breakdown

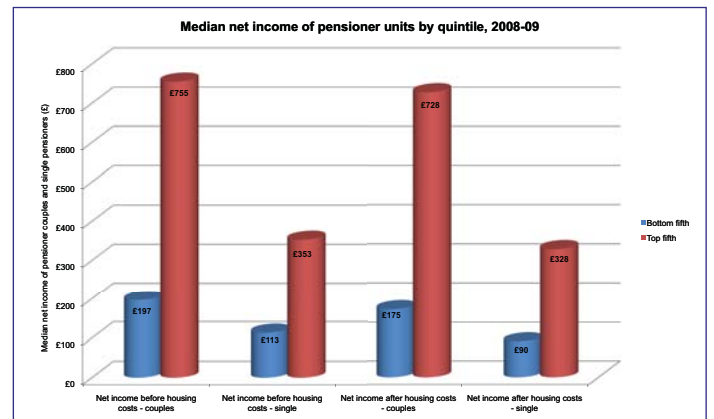
There are also variations in the level of income across age groups with recently retired people tending to have more income than the under 75s and people 75 and over. This trend applies for people who are single and are in a couple. Recently retired pensioners obtain more of their income from earnings than older pensioners, who are less likely to be in work. It is worth noting that benefit income accounts for a greater proportion of overall income as people get older.

Within all age groups, men, on average have higher incomes than women. Single men have an average net income after housing costs of £229 per week in 2008-09 compared to £198 for single women.



Distribution of wealth

Ranking the pensioner population by quintiles (five equal sized groups), the report highlighted the fact that the median net income (before and after housing costs) for pensioner couples in the top fifth quintile was around four times that of the bottom fifth quintile. For single pensioners the median net income for the top fifth was around three times that of the bottom fifth.



Median net income of pensioner units by quintile, 2008-09

| | Bottom fifth | Top fifth |
|---------------------------------|--------------|-----------|
| Pensioner Couples | | |
| Net income before housing costs | £197 | £755 |
| Net income after housing costs | £175 | £728 |
| Single Pensioners | | |
| Net income before housing costs | £113 | £353 |
| Net income after housing costs | £90 | £328 |

Finally, the report found that the amount of income from state benefits in 2008-09 is fairly even across the distribution of pensioner couples but is inversely related to overall income for single pensioners. The bottom fifth of single pensioners receive most of their income from benefits. For pensioner couples occupational pensions grow as we move up the distribution. Income from investments and earnings also increase as we move up the income distribution for couples and singles.

Overall pensioners' income across all groups grew albeit at different rates for different pensioner units. The main element of pensioner incomes is largely state provided; but the proportion of income from occupational pensions and personal pensions continue to grow.



Escalating pensions

Increases to occupational pensions will now be linked to CPI rather than RPI

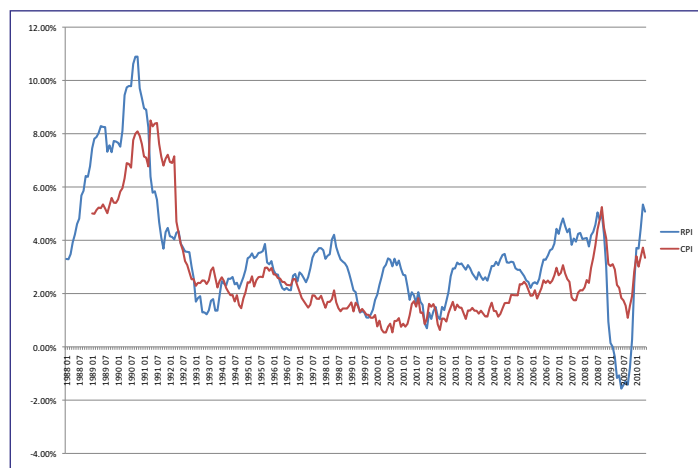
On 8th July 2010, Pensions Minister Steve Webb announced there would be an amendment to regulations originally introduced in the Pension Schemes Act 1993, requiring occupational schemes to revalue and escalate accrued pensions in line with what is known as the Limited Price Index (LPI). In the Pension Schemes Act 1995, the LPI is declared once a year and is equivalent to the rise in the Retail Prices Index (RPI) over a 12 month period ending on 30th September, subject to a cap of 5% or for benefits accrued after 6th April 2005, 2.5%. The Minister's announcement changes the link from the RPI to the Consumer Prices Index (CPI) on all affected benefits.

The change applies not only to escalation on pensions in payment but also to any deferred benefits that are subject to revaluation between date of leaving service and date of retirement.

Significant reductions?

This is likely to mean that increases in pension payments will be lower than they would have been prior to the announcement.

The difference between RPI and CPI from time to time can be significant. The difference over the 12 months to May 2010 was 1.74%. If this were repeated consistently over 20 years, it could result in a starting pension of £10,000 being more than £7,000 per year less than would have been paid with RPI escalation (£19,300 compared with £26,900) by the end of the period.



However, over the longer term, the difference between RPI and CPI will not necessarily be so high. The average rate of increase in the RPI over the 10 years to May 2010 was 2.74% per year while the average rate of increase in the CPI was 2.07% per year. If this difference were to continue over the next 20 years, a pension starting at £10,000 per year would grow to £15,067 with escalation equivalent to CPI compared with £17,158 with escalation equivalent to RPI, a loss in income of £2,089 in that year. The picture is further complicated by the fact that the change applies to pensions subject to (LPI) which can be capped at 5% or 2.5% per year, dependent on when the benefit was accrued. This should, in principle, limit the difference even more.

The new rules will not apply to individual pensions or occupational defined contribution schemes, most of which do not purchase index-linked incomes in any event.

Retirement planning

DB schemes still generally provide a higher level of benefits than DC schemes by virtue of higher contribution rates, albeit for declining numbers of employees in the private sector, and this change is unlikely to reverse that position. Nevertheless, the change may lead to many scheme members having to resort to using other assets to support themselves in retirement and it is important that they are aware of all sources of additional income and capital. While the effect will take some time to manifest itself, this, together with increases in the State Pension Age could see increased interest in equity release.

Unlike many changes to pension legislation, the alteration affects benefits already accrued and is, therefore, retrospective in effect. The effective reduction of pension benefits in this way is regrettable but, if it results in an improvement in the funding position of some schemes, increasing their chance of survival, then it may be considered a price worth paying under the circumstances.



A decent pension

What constitutes a decent pension and how much will it cost?

From an adviser's perspective, every client's circumstances and needs are different and the actual level of a decent pension will differ accordingly but consideration of the principles can help to frame the discussion with many clients.

The Joseph Rowntree Foundation published a report in July 2008 showing that a pensioner couple needs a net income of £201 per week in order to maintain a minimum, socially acceptable quality of life, excluding housing costs. This is roughly equivalent to a gross income of £12,000 dependent on the precise source of the income. Housing costs, mainly Council Tax and maintenance, would increase this, possibly by a significant amount. The figure would also have to increase each year to keep pace with the rising cost of living.

This gives an indication of the minimum income required to survive but many would expect significantly more in order to enjoy what they may have always viewed as their longest holiday.

Another way of looking at the picture is to relate pension income to income before retirement. The Annual Survey of Hours and Earnings (ASHE) shows that average earnings for a male earner in 2009 were £27,600. To the extent that any planning takes place, many people will plan for a pension of two-thirds of final earnings for the simple reason that this is a figure often quoted as reasonable. This would represent a pension of £18,400 in the case of someone on average earnings.

A married couple who receive the married couple's Basic State Pension (£8,119 per year) would have to find an additional income of £10,280 per year. A certain proportion may be provided from the State Second Pension and SERPS entitlement, say £5,000 per year.

This would still leave £5,280 per year from their own funds, inside or outside of pensions. The approximate cost of an inflation-linked pension with provision for a spouse on death of the annuitant is, at present rates, £141,000.

The cost of providing the pension can be reduced by foregoing inflation protection or a certain proportion of spouse pension. In either case, foregoing the benefit will reduce the future living standard of one or other of the couple, possibly both. For example, removing the requirement for an inflation-linked pension would reduce the fund size to around £88,500. Reducing the spouse's pension to 50%, while retaining inflation protection, would require a fund of around £128,000. Removing escalation and reducing the spouse pension to 50% would reduce the fund required to £82,000. Even with no spouse pension and no escalation, the required fund would be £76,000 and then, in this situation, funds would need to be available from other sources to provide some protection against inflation and for an income for the spouse in the event of the annuitant's death.

These funds would not need to be in a pension, or could be held in a USP environment until needed. Changes in the maximum age limit for USP, announced in the recent Budget may facilitate this type of planning using pensions. Alternatively, assets held outside of pensions, whether in ISAs, investment bonds or any other investment already offer sufficient flexibility.

Taking an enhanced annuity could reduce the fund required to provide spouse pension and escalation to £110,100 if both qualified, or £75,700 if escalation were removed. This is still higher than the level of most individual pension funds but would certainly help to close the gap somewhat.





Tax relief

There is significant potential for reducing tax relief on pension contributions - a cause for concern?

Pension tax relief is under the spotlight. The previous Government effectively negated much of the benefit of simplification by introducing a restriction on tax relief that could be claimed by those earning over £150,000 p.a. - and then complicated the picture even more by bringing those earning more than £130,000 under the new rules.

The Coalition Programme for Government contained very little on pensions but there are a number of reviews of various aspects that will be reporting in the not too distant future. The Budget indicated that the Government intends to repeal the tapering of tax relief in favour of a reduced Annual Allowance, between £30,000 and £45,000 which should help simplify the whole issue enormously. Another aspect that has been changed, and is now in consultation, is the effective requirement to purchase an annuity at age 75 and liberalisation of the tax treatment of funds on death after age 75. Other reviews are looking at public sector pensions, auto-enrolment and the future of NEST.

One aspect that has not been widely mentioned is the overall issue of tax relief on pensions. The Government has, so far, not committed to reducing relief any further beyond the reduction of the Annual Allowance. There are, however, calls for the whole pension system to be reviewed and, mostly, simplified. Given the level of tax relief given on pensions and the way it is paid, this is one subject that could come under further scrutiny.

According to "Simplification is the key," by Michael Johnson, many people believe that the primary purpose of tax relief should be to reduce pensioner poverty and that there is a strong case for ending all pension savings tax relief, using the savings to boost the Basic State Pension. This is likely to be considered a step too far in the current environment but, given that the paper also maintains that less one in six of those who are higher rate taxpayers when working continue to pay higher rate in retirement, there may be more interest in some level of reduction or restriction.

The Liberal Democrats had a stated policy of restricting relief to basic rate. How much further they are prepared to go remains to be seen - but, perhaps, not for very long.

Tax relief granted

HMRC publishes figures for the amount of tax relief paid and, to balance this, the amount of tax received from pensions in payment. Given the current state of uncertainty, a summary may be of interest. In tax year 2008/09, relief of £15.8 billion was given on contributions to occupational schemes: £11.6 billion on employers' contributions and £4.2 billion on employees' contributions. A further £5.4 billion was given on contributions to personal pensions and RACs. HMRC calculates that relief on investment income is worth another £6.7 billion.

Pension Trends from ONS, estimates the cost of tax relief on pension commencement lump sums at a further £2.5 billion.

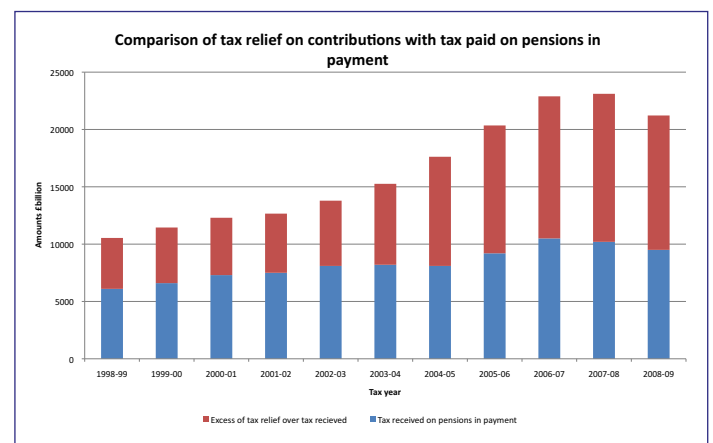
According to the notes supplied with the data, the average tax rate relieved on contributions is about 30%.

Tax received

On the other side, tax paid on pensions in payment amounted to £9.5 billion in 2008/09, estimated to be an average rate of 17%.

Thus, ignoring National Insurance rebates, National Insurance relief on employer contributions and relief on lump sum payments from unfunded schemes, tax relief exceeded tax receipts by £18.4 billion, or £20.9 billion if relief on PCLS is included.

The excess of tax relief over receipts from pensions in payment has doubled since 2002/03 but as the number of pensions in payment increases, the margin between the two is likely to shrink although the tax paid in retirement may still be lower than the level of relief granted overall.



Potential to restrict relief

All figures are believed to be subject to a wide margin of error and it is, therefore, difficult to judge how attractive the Government would find the prospect of reducing the gap further in order to shore up the UK budget but it is clear that the amounts involved might be quite tempting. Weighed against this, of course, is the potential erosion of faith in the value of saving into pensions if the government is seen to be periodically interfering with structure.

Reducing tax relief on contributions is not the only option and it does have the disadvantage, from the government's perspective, of being obvious and easy to understand. Another alternative may be some form of restriction on the PCLS, which is frequently the subject of speculation.

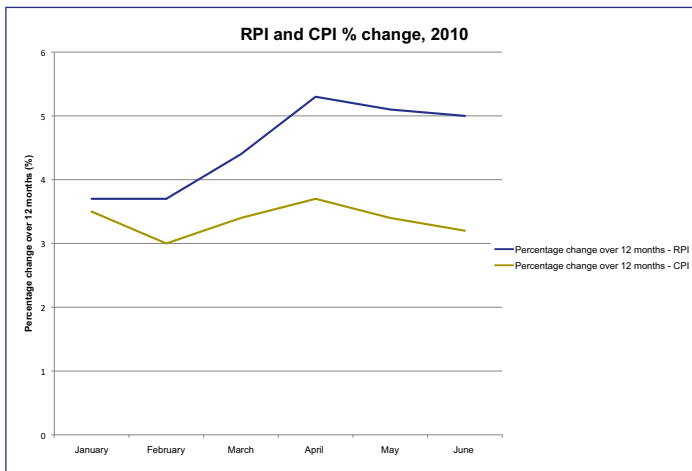
May and June inflation

The Government's measure for inflation, Consumer Prices Index (CPI), was 3.2 per cent in June falling from 3.4 per cent in May. This was the second consecutive decrease after a sustained period of increases. The largest downward pressure to the change in CPI came from falling petrol and diesel prices followed by clothing and footwear where price falls were a record for the June sales season.

The Retail Prices Index (RPI), rose by 5 per cent, down from 5.1 per cent in May, with the largest downward pressure coming from the same factors that affected CPI.

From April to May, CPI decreased from 3.7 per cent in April to 3.4 per cent in May, a decrease facilitated by the fall in prices of food and non-alcoholic beverages. Transport also contributed to the downward pressure on CPI between April and May, where fuel prices rose by 0.3 per cent between April and May compared with a 2.4 per cent rise a year ago.

May's RPI was 5.1 per cent down from 5.3 per cent in April, with the largest downward pressure coming from food, where prices rose between April and May but less than a year ago.



In March, the Office of National Statistics (ONS) changed the way it calculated UK inflation rates: specifically the mortgage interest payment element of RPI. Previously RPI measured mortgage interest payments using standard variable interest rates. This was replaced by an effective rate with a wider scope. The new rate takes account of the interest rates of tracker and fixed rate mortgages to better reflect the types of mortgages rates available.

The ONS has also changed the items in the basket of goods and services which are used to measure RPI and Consumer Prices Index (CPI); removing items such as bars of soap and lipstick and replacing them with liquid soap and lip-gloss. This is to better reflect the changes in consumer spending patterns and is done a regular basis.

In June, the Government announced that it will adopt CPI for increases to a range of State benefits.

